No. 88-36

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

BENEFICIAL CORPORATION,
FINN M.W. CASPERSEN, ANDREW C. HALVORSEN,

Petitioners,

– against –

ROBERT M. DEUTSCHMAN,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTION PRESENTED

Does a plaintiff who purchased securities on a national securities exchange, namely call options to purchase common stock of Beneficial Corporation ("Beneficial"), have standing under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, to bring an action for securities fraud, arising from affirmative misrepresentations made by Beneficial and its chief executive and financial officers, relating to the business, operations, and financial condition and results of Beneficial, where those affirmative misrepresentations artificially inflated the market price of the common stock of Beneficial and the market price of call options to purchase that common stock?

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Respondent Robert M. Deutschman respectfully requests that this Court deny the Petition for Certiorari to the United States Court of Appeals for the Third Circuit (the "Petition") submitted by Beneficial Corporation ("Beneficial") and the two individual petitioners (collectively, the "Petitioners") to review a judgment of the United States Court of Appeals for the Third Circuit. The judgment reversed the Order of the United States District Court for the District of Delaware granting Petitioners' motion to dismiss the Respondent's complaint for lack of standing and jurisdiction.

STATEMENT OF THE CASE

Respondent's Amended Complaint is brought under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78(j)(b), 78(t)(a) (the "Exchange Act") and Securities and Exchange Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC"), 17 C.F.R. 240.10b-5. Respondent brings this action as a class action pursuant to Rules 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of a class consisting of all persons who purchased the common stock of Beneficial during the period August 21, 1986 through February 27, 1987, or purchased call option contracts thereon during that period, and have sustained a loss. There have been no rulings or proceedings as to class certification.

Issue has not been joined. On March 27, 1987, Petitioners filed a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure on the grounds that (i) Respondent, a purchaser of Beneficial call option contracts, lacks standing under Section 10(b) of the Exchange Act and Rule 10b-5; (ii) the Amended Complaint fails to state a claim upon which relief can be granted; and (iii) there is no pendent jurisdiction over the common law claim of negligent misrepresentation.

Discovery was deferred pending a ruling by the District Court on the motion to dismiss. Limited discovery is now proceeding in the District Court. Should this Court grant the Petition for Certiorari, however, discovery will be automatically stayed pursuant to rulings of the Court made on June 20, 1988.

On July 30, 1987, the District Court dismissed the Amended Complaint, holding that (i) Respondent has no standing under the federal claim and, therefore, (ii) the District Court lacks jurisdiction over the pendent state law claim. *Deutschman v. Beneficial Corp.*, 668 F.Supp. 358, 364 (D. Del. 1987)(App. 25a).[1]

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[1] References to "App ____" are to Petitioners' Appendix. Respondent's Amended Complaint is reproduced in the Appendix to this brief and will be referred to as "Resp. App. ____".

Apart from the issue of standing, the Court did not pass on whether the Amended Complaint fails to state a claim upon which relief can be granted.

On March 7, 1988, the United States Court of Appeals for the Third Circuit reversed the District Court, holding that Respondent, a purchaser of a call option, which concededly is a security, has standing to seek damages under Section 10(b) for securities fraud arising from the affirmative misrepresentations made by Petitioners relating to the business, operations, and financial condition and operating results of Beneficial, where the affirmative misrepresentations artificially inflated the market price of the common stock of Beneficial and of call options to purchase that common stock. In so finding, the Court of Appeals expressly accepted the fact that changes in the market value of an option contract correlate directly to changes in the market price of the underlying stock. *Deutschman v. Beneficial Corp.*, 841 F.2d 502, 504, 505, 507-508 (3d Cir. 1988). (App. 6a, 12a).

The Court of Appeals held that Respondent's "complaint appears . . . to satisfy every requirement for a Section 10(b) damage action imposed by the Supreme Court when dealing with affirmative misrepresentations which may affect the market price of a security." *Id.* at 506. (App. 9a).[2]

The Court of Appeals properly accepted as true the factual allegations of the Amended Complaint in considering the District Court's ruling under Rule 12(b)(6). In this regard:

> . . . Deutschman alleges that in 1986 and part of 1987 Beneficial's insurance division suffered severe losses

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[2] Petitioners did not raise below any issue as to the materiality of the affirmative misrepresentations; nor did they claim the Amended Complaint fails sufficiently to plead fraud with specificity; nor did the Petitioners challenge that Respondent was in fact a purchaser of a security or the applicability of the now accepted and well-recognized fraud-on-the-market theory. *Basic v. Levinson*, ____ U.S. ____, 108 S.Ct. 978, 988-992 (1988). Apart from the controverted issue of standing, it cannot be denied that Count I of Respondent's Amended Complaint sufficiently states a federal claim.

> which had an adverse impact on Beneficial's financial condition; that Caspersen and Halvorsen held stock and stock options in Beneficial which would be adversely affected by a decline in the market price of that stock; that disclosures were made about the losses in Beneficial's insurance division which caused declines in that market price; that in order to prevent further declines Caspersen and Halvorsen, on Beneficial's behalf, issued statements about the problems in the insurance division, which they knew to be false and misleading, to the effect that those problems were behind it and were covered by sufficient reserves; that these misleading statements placed an artificial floor under the market price of Beneficial stock; that purchasers of Beneficial stock and purchasers of call options in Beneficial stock made purchases at prices which were artificially inflated by the market's reliance on defendants' misstatements, and that both purchasers of Beneficial stock and purchasers of Beneficial call options suffered losses as a consequence. Beneficial stock is traded on the New York Stock Exchange and on other national stock exchanges. Options on Beneficial stock are traded on the Pacific Stock Exchange. The complaint does not allege that Beneficial, Caspersen, or Halvorsen, during the time period complained of, traded in Beneficial stock or in put or call options on Beneficial stock. It alleges that Deutschman suffered losses when, upon disclosure of the facts, call options on Beneficial's stock that he had purchased in reliance on the market price created by defendants' misstatements, became worthless. It does not allege that Deutschman purchased Beneficial stock.

Deutschman v. Beneficial, 841 F.2d at 503-504. (App. 3a-4a).

On April 4, 1988, Petitioners filed a petition for rehearing *en banc* which petition was denied by the Court of Appeals on April 4, 1988. (App. 29a).

SUMMARY OF ARGUMENT

The Petition for a Writ of Certiorari should not be granted for the following reasons: (1) the disposition by the Court of Appeals of the question presented was in conformity with applicable decisions of this Court and the legislative intent as expressed in the Exchange Act; (2) no other federal court of appeals has decided the exact question presented and the decision of the Third Circuit does not conflict with any rulings of a Court of Appeals of another Circuit; (3) the Third Circuit's decision below has no serious ramifications beyond the facts alleged with specificity in the Amended Complaint and does not involve an unprecedented expansion of the long-recognized private right of action under Section 10(b) and Rule 10b-5; (4) the question presented, raised in the context of a motion addressed to the legal sufficiency of the claim based on a presently undeveloped factual record, does not involve an important issue of federal law; and (5) Petitioners are improperly seeking advisory opinions of this Court as to irrelevant issues.[3]

The Third Circuit made no sweeping pronouncements. The precise holding of the Court is that a purchaser of an option contract to purchase securities (a "call") has standing to seek damages under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder for affirmative misrepresentations. *Deutschman v. Beneficial*, 841 F.2d at 508 (App. 13a). The decision of the Court applies relevant Supreme Court precedent as well as relevant landmark opinions from various Courts of Appeals. Nothing in the

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[3] Given the present posture of this litigation, where issue has not been joined, class certification has not been resolved, and the facts have not been developed, Petitioners' argument as to the "serious ramifications" of the decision of the Third Circuit is strained. (Petition at 2). The flaws in the Petition are evident by the extent to which it contains superfluous matters outside the record relating to such subjects as index options and "uncovered" or "naked" options. (Petition at 9-11). The record does not reflect, nor does the Amended Complaint reflect, that Respondent purchased or wrote naked options or index options or any new kind of investment instrument. As the Third Circuit found, call option contracts, the relevant security, have been traded on national securities exchanges since 1973 and in the unlisted securities market for more than 100 years. *Deutschman v. Beneficial*, 841 F.2d at 504. (App. 5a).

decision conflicts with opinions of this Court or of any Court of Appeals of the United States. Since the decision of the Court of Appeals for the Third Circuit is in conformity with prior law on the question presented, and does not decide any novel issues, no important question of federal law is involved.

Moreover, Petitioners' gratuitous litany of the risks of investing in options, without the benefit of expert testimony, ignores the fact that options trading is beneficial to the economy and the securities markets and can be a risk reducing investment strategy. The description in the Petition of other types of derivative securities is similarly irrelevant to the question presented at bar. This class action does not involve index options or "uncovered" or "naked options" (Petition at 9-11). Respondent only seeks damages for himself and others similarly situated, namely, those who purchased common stock of Beneficial or call options thereon in the impersonal market of national securities exchanges during an approximate six-month period. Petitioners nonetheless would have the Court hold that a purchaser of a call option under no circumstances at any time may bring an action under the 1934 Act — and thereby have the Court disqualify *per se* such an investor's federal claim.

Respondent, a purchaser of securities, is surely one of the primary intended beneficiaries of the Exchange Act, since the purpose of that Act is the protection of investors. The decision below is consistent with that purpose.

ARGUMENT

I.

THE DECISION OF THE COURT OF APPEALS FOR THE THIRD CIRCUIT DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OR OF ANY OTHER COURT OF APPEALS

A. *Contrary to the Argument of Petitioners, Section 10(b) of the Exchange Act is Intended to Protect Investors Who Purchase Calls On a National Securities Exchange. The Third Circuit So Determined, Consistent with the Decisions of this Court.*

The statutory scheme underlying the Exchange Act intends to afford standing to Respondent to seek redress for actual damages sustained as a result of materially false and misleading reports and press releases disseminated to the investing public by Petitioners. Because protection for option purchasers, like purchasers of common stock, falls within the plain language of the statute; because protection to these securities purchasers is within the intent of Congress; and because such protection is consistent with the legislative intent, an options purchaser has standing to bring an action for fraud under Section 10(b) and Rule 10b-5 against an issuer of the stock, which underlies the option, where that issuer and its officers caused false and misleading reports about the issuer to be disseminated to the investing public.

This Court has recently affirmed that "[j]udicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of §10(b) [of the Exchange Act] and Rule 10b-5 [promulgated thereunder], and constitutes an essential tool for enforcement of the Exchange Act's requirements." *Basic, Inc. v. Levinson*, ____ U.S. ____, 108 S.Ct. 983 (1988) citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975).

The 1934 Act was designed to protect investors against manipulation of stock prices. See S.Rep. No.

> 792, 73d Cong., 2d Sess. 1-5 (1934). Underlying the adoption of extensive disclosure requirements was a legislative philosophy: "There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy." H.R.Rep. No. 1383, 73d Cong., 2d Sess., 11 (1934). This Court "repeatedly has described the 'fundamental purpose' of the Act as implementing a 'philosophy of full disclosure.' " *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-478, 97 S.Ct. 1292, 1303, 51 L.Ed.2d 480 (1977), quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186, 84 S.Ct. 275, 280, 11 L.Ed.2d 237 (1963).

Basic v. Levinson, 108 S.Ct. at 982.

Purchasers of calls, an explicitly defined security under §2 of the Exchange Act,[4] have standing to seek damages for violations of Section 10(b) just as purchasers of common stock do. Unlike other provisions of the federal securities laws,[5] "a Section 10(b) action can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative device or contrivance' in connection with the purchase or sale of a security." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983)

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[4] In the Act of October 13, 1982, P.L. 97-303, §2, Stat. 1409, Congress amended the Exchange Act to unequivocally include "any put, call, straddle, option or privilege on any security," within the definition of a security. This amendment arose out of a recognition of the proliferation of financial instruments designed to hedge against, among other things, stock market fluctuations and the resulting necessity to clarify and confirm the SEC's authority to regulate trading in such instruments. *See, e.g.*, U.S. Code Cong. and Admin. News, Pub. L. 97-303, at 2780-81. Even prior to the 1982 amendment, however, calls and other options on securities were clearly considered securities for purposes of Section 10(b). *Blue Chip Stamps*, 421 U.S. at 751. *See also Deutschman v. Beneficial*, 841 F.2d at 505, n. 1 (App. 7a). Given the indisputable long and well recognized existence of an implied private right of action under Section 10(b), Congress would have explicitly excluded calls from the "any security" language of Section 10(b), had it wanted to deprive purchasers of calls from seeking damages under Section 10(b). *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 383-87 (1983).

[5] *See, e.g.*, 15 U.S.C. §§77k and 77l.

emphasis in original). Indeed, this Court has repeatedly emphasized that the definition of "security" under the Exchange Act is "quite broad." *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985).

Undoubtedly, Respondent, a purchaser of a call to which the misrepresentations of Petitioners relate, is within the class of persons for whose "especial benefit" Section 10(b) was enacted. *Cort v. Ash*, 422 U.S. 66 (1975).

The purpose of the Exchange Act further supports the intended coverage of Section 10(b) to include purchasers of calls which are traded on a national securities exchange and whose purchasers are as affected by misrepresentations relating to the underlying common stock as the stockholders themselves. "The market price for options is directly responsive [] to changes in the market price of the underlying stock, and to information affecting that price." *Deutschman v. Beneficial*, 841 F.2d at 504 citing Rubinstein, *An Economic Evaluation of Organized Options Markets*, 2 Journal of Comp. Corp. Law and Sec. Reg. 49 (1979) (App. 5a).

Had Respondent purchased 5500 common shares of Beneficial common stock on the New York Stock Exchange on November 25, 1986 and December 12, 1986, instead of 55 call option contracts purchased on those dates, and had Respondent sold the shares at a loss the week of January 12, 1987 when the option contracts expired (Resp. App. 2-3), Respondent unquestionably would have standing to prosecute the action. This would have been so, even though the Respondent would not have dealt with Petitioners, would not have purchased his Beneficial common stock from them but would have purchased those shares in the impersonal trading market of the New York Stock Exchange from some stranger who would have been the recipient of the net proceeds (after commissions) of that purchase. Petitioners would not have benefited one iota from such a transaction, would not have been involved, and could argue as they do here that they had no relationship in that particular transaction with the purchaser.[6]

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[6] Hundreds of shares of common stock of Beneficial are traded daily on the New York Stock Exchange not involving Petitioners. Likewise, there are numerous

(Footnote continued)

Nonetheless, the standing of such a purchaser of common stock to prosecute a 10b-5 action is clear. *Basic v. Levinson*, 108 S.Ct. at 983.

The fundamental purpose of implementing a philosophy of full disclosure to promote honest markets dictates that protection be provided to victims of fraud perpetrated on all the securities markets which are linked together and function harmoniously. As explained by one commentator, "the inclusion of call options as securities is even more compelling when one considers the relationship between the call option and the underlying security, because the option holders' financial success is determined by the activity of the underlying stock. The options investor is therefore clearly in the passive role which has classically resulted in SEC protection." Johnson, *Is it Better to Go Naked on the Street? A Primer on the Options Market*, 55 The Notre Dame Lawyer No. 1 at 30 (October 1979).

Notably, Section 20 of the Exchange Act was amended in 1984 in recognition of the intended coverage of the Exchange Act to include manipulations affecting the options market.[7] This enactment is "indicative of contemporary congressional intent to include options investors within the class of beneficiaries of Rule 10b-5. . . ." Note, *Private Causes of Action for Option Investors under SEC Rule 10b-5: A Policy, Doctrinal, and Economic Analysis*, 100 Harv. L. Rev. 1959, 1962 (June 1987). The legislative history of this Insider Trading Sanctions Act reiterates the concern expressed by Congress in 1934, namely that " 'capital

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daily transactions in the Beneficial call option market on the Pacific Coast Exchange not involving Petitioners.

[7] Section 20, 15 U.S.C. §78t, as amended August 10, 1984, Pub. L. 98-376, §5.98 Stat. 1265, provides:

> (d) Liability for trading in securities while in possession of material nonpublic information.
>
> Wherever communicating, or purchasing or selling a security while in possession of material nonpublic information would violate, or result in liability to any purchaser or seller of the security under any provision of this chapter, or any rule or regulation

(Footnote continued)

formation and our nation's economic growth and stability depend on investor confidence in the fairness and integrity of our capital markets.' " *Id.* at 1966, n. 39.[8]

Thus, it would defy the express language and intent of the Exchange Act as well as logic to adopt the aritificial distinction sought by Petitioners vis-a-vis a purchaser of common stock and a purchaser of call options on that stock, both of whom rely on the salutary purposes of the Exchange Act to ensure their protection. As the Court of Appeals for the Third Circuit explained:

> The only standing limitation recognized by the Supreme Court with respect to Section 10(b) damage actions is the requirement that the plaintiff be a purchaser or seller of a security. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.) *cert. denied*, 343 U.S. 959 (1952). When in *Manor Drug Stores* the Supreme Court adopted the Birnbaum requirement that a Section 10(b) plaintiff can be a purchaser or seller of a security, however, it expressly recognized that such plaintiffs need

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thereunder, such conduct in connection with a purchase or sale of a put, call, straddle, option, or privilege with respect to such security or with respect to a group or index of securities including such security, shall also violate and result in comparable liability to any purchaser or seller of that security under such provision, rule, or regulation.

[8] Section 2 of the Exchange Act recites, *inter alia*, that "transactions in securities as commonly conducted upon securities exchanges ... are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters relating thereto ... to require appropriate reports ... and to impose requirements necessary to make such regulation and control reasonably complete and effective ..." 15 U.S.C. 78b. Protection would be less than complete if Respondent had no remedy under the statute. Section 18 of the Exchange Act provides an express cause of action to "any person" who shall have purchased a security at a price affected by a false and misleading filing and who relied on the filing. 15 U.S.C. 78r. Clearly, a purchaser of a call would have standing under that section. This Court has acknowledged that the federal courts have held that an express right of action under Section 18 would not bar an implied right of action under Section 10(b). *Huddleston*, 459 U.S. at 386.

> not be in any relationship of privity with the defendant charged with misrepresentation. 421 U.S. at 745. The underlying purpose of the 1934 Act was the protection of actual participants in the securities markets, and the *Birnbaum* rule was consistent with that purpose because it limited the class of plaintiffs to those who have at least dealt in a security to which the prospectus, representation, or omission relates. *Id.* at 747.

Deutschman v. Beneficial, 841 F.2d at 506 (App. 8a-9a).

B. *This is not an Insider Trading Case. Unlike an Insider Trading Claim, Respondent's Standing to Seek Damages Under Section 10(b) for Affirmative Misrepresentation Requires Neither a Specific Relationship Nor a Transactional Nexus Between Respondent and Petitioners.*

The causation element of a Section 10(b) claim for affirmative misrepresentation does not turn on a connection between the purchaser of the security and the wrongdoer – *i.e.*, a transaction between them – but instead depends on a connection between the wrongdoer's conduct and the purchaser's harm. Accordingly, in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), this Court held that the making of an untrue statement of a material fact and the omission to state a fact that could reasonably be expected to influence an investor's decision to buy or sell creates an affirmative duty to disclose the material fact. *Id.* at 153-54. Here, the damages of both the purchasers of common stock of Beneficial and the purchasers of call options thereon were caused by the same misrepresentations of Petitioners. The statements were not simply directed to the shareholders of Beneficial but were contained in public filings with the SEC, in newspapers, and in press releases transmitted to the investing public in general and, as such, could foreseeably impact, and did impact, the options market as well as the stock market. (Amended Complaint ¶¶25(a),(b), 28(a),(b), 29(a),(b),(c), 31, 34(c), 41-43; Resp.App. 12 to 25) This Court has recognized that the scope of corporate representations reaches a varied audience. *Blue Chip Stamps*, 421 U.S. at 745.

Petitioner's reliance on *Chiarella v. United States*, 445 U.S. 222 (1980) and *Dirks v. SEC*, 463 U.S. 646 (1983) is "entirely misplaced." *Deutschman v. Beneficial*, 841 F.2d at 506 (App. 9a). This Court did not hold in *Chiarella* that a relationship of "trust and confidence" between the plaintiff and the defendant is a prerequisite of every action brought under Section 10(b). What *Chiarella* did hold is that such a relationship is necessary between the parties to insider trading, *i.e.*, where the defendant, while in possession of undisclosed material information, traded in securities at the same time as plaintiff, a fiduciary duty or similar relationship of trust and confidence must be owed by the defendant to the plaintiff to trigger a duty on the part of the defendant to disclose the inside information or to abstain from trading.

Chiarella itself distinguished liability arising from affirmative misrepresentations, like here, and the liability from silence coupled with insider trading, like in *Chiarella*. This Court reasoned as follows:

> At common law, misrepresentation made for the purpose of inducing reliance upon the false statement is fraudulent. But one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information "that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them."

445 U.S. at 227-28. *See also Basic v. Levinson*, 108 S.Ct. at 988, n. 18 (noting difference between duty to "disclose or abstain" in insider trading context and "ever-present duty not to mislead" in the context of affirmative misrepresentations); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969)(while corporation was under no general duty to disclose, any statement the company voluntarily released could not be "so incomplete as to mislead").[9]

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[9] Petitioners' argument that no distinction can or should be made between cases involving non-disclosures and those involving affirmative misrepresentations

(Footnote continued)

Dirks involves the issue of the duty to disclose while in possession of material inside information and thus, like *Chiarella*, bears no relevance to the question presented here relating to the duty to tell the whole truth when one chooses to speak. This Court in *Dirks* merely reaffirmed the holding in *Chiarella* that when one is silent but trades on inside information the disclose or abstain duty is triggered if a relationship of trust exists between the parties. 463 U.S. at 657-58.[20]

The court below correctly interpreted this Court's holdings in *Chiarella* and *Dirks*:

> The district court's reliance on *Chiarella* and *Dirks* is entirely misplaced. Those cases dealt not with injury caused by affirmative misrepresentations which affected the market price of securities, but with the analytically distinct problem of trading on undisclosed information; a theory of recovery which Deutschman does not plead. The "disclose or abstain from trading" rule laid down in the insider trading cases imposes on insiders a duty to disclose information which need not otherwise be disclosed before they act on that information in any uninformed marketplace.
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> * * *

(Petition at 20) ignores the clear distinction made in *Chiarella* and in other cases for the purpose of determining whether plaintiffs should be afforded a presumption of reliance. *Affiliated Ute Citizens*, 406 U.S. at 153 (1972); *du-Pont v. Brady*, 828 F.2d 75 (2d Cir. 1987). *See also Peil v. Speiser*, 806 F.2d 1154, 1161, n.11 (3d Cir. 1986). Furthermore, two independent legal theories for recovery – (1) justifiable reliance on false statements, and (2) failure to speak when under a duty to disclose – are easily differentiated. No court has adopted Petitioners' proposal.

[20] Similarly, *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 35-37 (1977) is inapposite. There, this Court found that the purpose of the Williams Act was to ensure that public investors have adequate information to make an investment decision in connection with a tender offer. This Court refused to extend the protection of the Williams Act to competing bidders for a target company. Here, the Third Circuit, consistent with the purpose of the Exchange Act to protect all investors, properly recognized that the Exchange Act is intended to

(Footnote continued)

> *Chiarella* and *Dirks* involve only the question of when outsiders and nonfiduciaries will be treated as insiders or fiduciaries for purposes of the affirmative duty to disclose or refrain from trading. The court in those cases declined to extend the duty to disclose or abstain to mere tippees who came into possession of otherwise undisclosed information. Nothing in those opinions, however, can be construed to require the existence of a fiduciary relationship between a section 10(b) defendant and the victim of that defendant's affirmative misrepresentation. Except to the extent that other federal statutes may have imposed a disclosure obligation (none are relied on by Deutschman), Beneficial and its officers were free to keep quiet about its business affairs so long as they stayed out of the market. According to Deutschman, however, they chose to speak, and in speaking they were not free to lie. [Citations omitted.]

Deutschman v. Beneficial, 841 F.2d at 506 (App. 9a-10a).

Likewise, "[n]o Supreme Court case and no Court of Appeals case has ever imposed a transactional nexus requirement in a section 10(b) affirmative misrepresentation case." *Id.* at 507 (App. 11a).[11]

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equally protect purchasers of common stock and purchasers of options to acquire that common stock from affirmative misrepresentation which adversely impact the market price of both the options and the underlying stock. *Texas Gulf Sulphur*, 401 F.2d 833, also relied upon by Petitioners, indeed supports Respondent's position. In that case the Court made clear that "[. . . the speculators and chartists of Wall and Bay Streets are also 'reasonable' investors entitled to the same legal protection afforded conservative investors." *Id.* at 849. The fact that *Texas Gulf Sulphur* involved the purchase of the corporation's securities does not mean that purchasers of call options on Texas Gulf Sulpher stock would have lacked standing. In fact, those defendants in *Texas Gulf Sulphur* who purchased calls were found to have violated Rule 10b-5.

[11] Petitioners' citation of *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979) for the proposition that tort principles alone cannot justify implication of a private right of action makes clear Petitioners' misunderstanding of the analysis of the Third Circuit. Statutory construction formed the basis of the decision. *Deutschman v. Beneficial*, 841 F.2d at 505-506 (App. 6a-9a). The discussion by that Court

(Footnote continued)

Indeed, this Court has specifically rejected the notion of privity, or in Petitioner's words, a "transactional nexus," as a prerequisite to a cause of action under Section 10(b) for affirmative misrepresentations:

> "In today's universe of transactions governed by the 1934 Act, privity of dealing or even personal contact between potential defendant and potential plaintiff is the exception and not the rule. The stock of issuers is listed on financial exchanges utilized by tens of millions of investors, and corporate representations reach a potential audience, encompassing not only the diligent few who peruse filed corporate reports or the sizable number of subscribers to financial journals, but the readership of the Nation's daily newspapers. Obviously neither the fact that issuers or other potential defendants under Rule 10b-5 reach a large number of potential investors, or the fact that they are required by law to make their disclosures conform to certain standards, should in any way absolve them from liability for misconduct which is proscribed by Rule 10b-5." (Emphasis added.)

Blue Chip Stamps, 421 U.S. at 745. *See also Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974)(specifically rejecting the argument that a Rule 10b-5 claim for relief must include a "direct transaction [] between plaintiffs and defendants.")

An underlying rationale for the decision of the Third Circuit is that because the market value of an option contract is responsive to changes in the market value of the underlying stock,

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of the tort theory of proximate cause is to rebut the District Court's reliance on *Chiarella*, *Dirks* and other silence cases. In any event, the existence of an implied right of action under Section 10(b) and Rule 10b-5 is no longer open to dispute. *Basic v. Levinson*, 108 S.Ct. at 983; *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13, n.9, (1971); *Affiliated Ute Citizens*, 406 U.S. 128; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983).

holders of option contracts are susceptible to affirmative misrepresentations which cause the price of the stock to move. This fact satisfies the proximate cause requirement delineated in cases such as *Peil v. Speiser*, 806 F.2d 1154 (3d Cir. 1986). The existence of proximate cause defines the limits of the class to which the wrongdoers are liable. The reasoning of the Third Circuit, in this regard, properly relies on *Blue Chip Stamps*.[12] *See Deutschman v. Beneficial*, 841 F.2d at 507 (App. 11a-12a).

Although the decision of the Third Circuit is not premised upon per se nor does it specifically mention the "fraud on the market" theory, despite Petitioners' claim to the contrary (Petition at 16), the logic of the theory is applicable here. The "fraud on the market" theory, affording a presumption of reliance in Section 10(b) cases, arises out of the recognition that investors rely on the integrity of open and developed securities markets and can thus be defrauded by material misrepresentations which artificially inflate those markets without necessarily relying on the misstatement itself. *See e.g. Basic v. Levinson*, 108 S.Ct. at 988-92. Purchasers of call options rely on the integrity of the market for the call options and the market for the stock upon which the calls are derived. Call option purchasers buy in anticipation of the market price of the stock increasing just as stock purchasers do. In this sense, both call and stock purchasers rely on their "own belief that the market price of the underlying common stock is not reflective of its true value." (Petition at 16). *Basic v. Levinson*, 108 S.Ct. at 991 (" 'it is hard to imagine that there is ever a buyer or seller who does not rely on market integrity. Who

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[12] In *Blue Chip Stamps* this Court held that a company who pursuant to an antitrust decree acquired a right to purchase units consisting of shares of the defendant corporation's common stock and debentures, but who did not exercise the right because of a misleadingly pessimistic prospectus disseminated by the corporate defendant, was not a "purchaser" within the meaning of Section 10(b) of the Exchange Act. The holding was based on the reluctance to extend protection to "bystanders to the securities marketing process" who have not dealt in the security to which the representation or omission relates and who would necessarily have difficulty proving they decided *not* to purchase the security. 421 U.S. at 747. Otherwise, according to this Court, "the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove that he ever consulted a prospectus of the issuer, that he

(Footnote continued)

would knowingly role the dice in a crooked crap game?' ") (Citation omitted).[13]

C. *The Holding of the Court of Appeals for the Eighth Circuit in* Laventhall *Involving Insider Trading Does Not Conflict With the Decision Below of the Court of Appeals for the Third Circuit.*

The facts of *Laventhall v. General Dynamics Corp.*, 704 F.2d 407 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983) are "quite distinguishable" from those presented here. *Deutschman v. Beneficial*, 841 F.2d at 506 (App. 10a).

The plaintiff in *Laventhall* was a seller of option contracts on General Dynamics stock at a time General Dynamics was buying common stock in the open market without disclosing its intention to declare a cash dividend. There was no disclosure by General Dynamics of the intent to declare a dividend; the company was silent on the subject. Thus, the issue in *Laventhall* was whether the company in purchasing its own stock had a duty to a seller of calls to disclose its intention to declare a dividend on its common stock. The Court of Appeals for the Eighth Circuit held no such duty was owed because it failed to find a "transactional nexus between *defendant's trading* in its own stock and *plaintiff's loss*" resulting from plaintiff's sale of options on the stock of General Dynamics, without knowledge of the dividend declaration. 704 F.2d at 412.

The essential causal link between the defendant's fraud and the plaintiff's loss was missing in *Laventhall*, because assuming General Dynamics had not purchased its securities, the plaintiff

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paid any attention to it, or that the representations contained in it damaged him." *Id.* at 746. In contrast, like here, where one purchases securities at an artificially inflated price as a result of another's affirmative misrepresentation, and suffers a loss when the truth is ultimately disclosed, proof of purchase and loss are capable of documentary verification and there is no danger of promoting vexatious litigation by an indeterminate group of persons. *Id.*

[13] In *Zlotnick v. TIE Communications*, 836 F.2d 818, 822-23 (3d Cir. 1988), cited by Petitioners, the Third Circuit would not employ the presumption that

(Footnote continued)

would still have sold his options at the same loss without knowledge of the dividend declaration. In an insider trading case like *Laventhall*, damages are measured by the ill-gotten gains derived from those with whom the insider trades, in that case the shareholders of General Dynamics. *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 172-73 (2d Cir. 1980).

In contrast, the causation element of a Rule 10b-5 cause of action is met here because had Petitioners not made the material affirmative misrepresentations complained of, the price of Beneficial common stock and thus the price of call options thereon would not have been artificially inflated, and Respondent would not have suffered the loss that he did when the true facts were belatedly disclosed. Here, there is a direct causal relationship between Petitioners' wrongful conduct and Respondent's damages.

The language of *Laventhall* regarding the lack of a "transactional nexus" in that case must be restricted to cases arising out of analogous facts, namely silence cases involving the trading by defendants in the stock of the subject corporation. Thus, the fact that Petitioners did not trade options on Beneficial common stock is irrelevant.

Similarly, when the Court in *Laventhall* held that the plaintiff in an insider trading case must have a "special relationship" consisting of "trust and confidence" with the defendant, the Court was simply applying judicial precedent developed in the unique context of insider trading liability to an insider trading case. *Laventhall*, 704 F.2d at 412-13, quoting *Chiarella*. As explained in *Chiarella*, the relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with

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the market price of the stock reflected all available information when a short seller made covering purchases believing that the market price of the stock was overvalued. In that case, although holding that a short seller has standing under Section 10(b), the Third Circuit found that the short seller, unlike Respondent, did not offer any empirical evidence on the nature of short sales to demonstrate why the presumption makes sense for short sellers as well as common stock purchasers. *Id.* at 822-823, n.7. Significantly, the Third Circuit here did not cite *Zlotnick* in its decision at bar.

the corporation gives rise to a duty to disclose, when no prior statement has been made, because of the necessity of preventing a corporate insider from taking unfair advantage of the uninformed stockholders. *Chiarella*, 445 U.S. at 228-231. However, as heretofore discussed, the legal effect of silence involves considerations far different from those arising from an affirmative act of misrepresentation which is fraudulent, irrespective of the existence of a relationship of trust. *Id.* at 228. Thus, according to the limited holding in *Laventhall*, an option purchaser lacks standing to assert a claim against the common stock issuer if the claim is based on breach of fiduciary duty.

Moreover, as found by the Third Circuit, "[t]he reasoning of the *Laventhall* case with respect to insider trading liability has been tellingly criticized." *Deutschman v. Beneficial*, 841 F.2d at 507 citing Note, *Private Causes of Action for Option Investors under SEC Rule 10b-5 . . .*", *supra*. The criticism was not further addressed by the Court, however, because, "like the *Chiarella* and *Dirks* holdings, [*Laventhall*] is simply not relevant to the distinct issue of affirmative misrepresentations affecting a market in securities." *Deutschman v. Beneficial*, 841 F.2d at 507 (App. 11a).[14]

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[14] Although the existence of conflicts among District Courts is generally not a ground for granting certiorari, all but one of the decisions of the District Courts dealing with the precise question presented, afford option purchasers standing under Section 10(b). *See e.g. In re Digital Equipment Corp. Securities Litigation*, 601 F.Supp. 311 (D. Mass. 1984); *Backman v. Polaroid Corp.*, 540 F.Supp. 667 (D. Mass. 1982); *O'Connor & Associates v. Dean Witter Reynolds, Inc.*, 529 F.Supp. 1179 (S.D.N.Y. 1981); *Lloyd v. Industrial Bio-Test Laboratories, Inc.*, 454 F.Supp. 807 (S.D.N.Y. 1978). Respondent respectfully submits that *Bianco v. Texas Instruments, Inc.*, 627 F.Supp. 154 (N.D. Ill. 1985) is wrongly decided.

In re McDonnell Douglas Corp. Securities Litigation, 567 F. Supp. 126 (E.D. Mo. 1983), like *Laventhall*, applies to allegations of trading without disclosing material inside information as well as to allegations of non-disclosure not involving affirmative misrepresentations, neither of which is applicable to the instant case. The Court in *Data Controls North, Inc. v. Financial Corp. of America*, ____ F.Supp. ____, 1988 U.S. Dist. LEXIS 4602 (D.Md. 1988), on a summary judgment motion, found no evidence of affirmative misrepresentations. In *Tolan v. Computervision Corp.*, C.A. No. 85-1396-N (D. Mass. December 8, 1987) the Magistrate, in his Report and Recommendation, found it "far from clear" whether the case was primarily one of affirmative misrepresentation or non-disclosure. In any event, the Magistrate followed the decision of

(Footnote continued)

II

POLICY CONSIDERATIONS DICTATE DENIAL OF THE PETITION

The Court of Appeals for the Third Circuit rejected the argument that purchasers of call options are entitled to less protection under the Exchange Act for three reasons: (1) the precise class for whose protection the Exchange Act was enacted is participants in the securities markets, of which purchasers of options are members;[15] (2) option contracts permit traders in common stock to engage in hedging transactions which are used to reduce exposure to market fluctuations and are thus risk reducing;[16] and (3) the soundness of the policy judgment leading to the creation of exchanges for option contracts and their treatment as securities is for Congress, the SEC, the Board of Governors of the Federal Reserve System and the Commodities Futures Trading Commission, not for the courts.[17]

Determining that call options are securities to be protected by the Exchange Act is consistent with the policy of that act as originally enacted. Restoring investor confidence in the securities

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the District Court in *Deutschman v. Beneficial* prior to reversal by the Third Circuit.

In *Starkman v. Warner Communications, Inc.*, 671 F.Supp. 297 (S.D.N.Y. 1987), the issue presented was "whether corporate insiders who fail to disclose material inside information and who sell shares in the corporation may be held liable under the anti-fraud provisions of the federal securities laws to persons who trade in options to purchase the corporation's securities," *id.* at 301, thus implying that *Starkman* is analogous to *Laventhall* and *McDonnell Douglas*. However, further in the opinion, during a discussion of issues not relevant here, Judge Walker refers to alleged material misrepresentations as well as omissions.

[15] *Deutschman v. Beneficial*, 841 F.2d at 507, *citing Blue Chip Stamps*, 421 U.S. 723 (App. 11a).

[16] *Deutschman v. Beneficial*, 841 F.2d at 507 (App. 12a).

[17] *Id.* (App. 13a).

markets was a primary reason for adopting the federal securities laws. *See* 1A Bromberg & Lowenfels, *Securities Fraud and Commodities Fraud*, §2.2(110) at 2:13 (October 1979) ("[Statutory antifraud provisions] were part of the initial New Deal response to the financial debacle of the 1920's, investigations of which revealed widespread fraud, manipulation and victimization of public investors by concealment of relevant information"). With respect to Section 10(b) and Rule 10b-5, courts have held that "[t]he statute and rule are designed to foster an expectation that securities markets are free from fraud — an expectation on which purchasers should be able to rely." *Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975). *See also*, *Lipton v. Documation*, 734 F.2d 740, 748 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985).

The Exchange Act requires Beneficial to file truthful reports with the SEC. 15 U.S.C. §§ 78l and 78m. These filings are typically analyzed by market professionals who formulate recommendations based upon the SEC filings. In turn, stock brokers rely on the analysts' reports in recommending particular securities to their customers. Overstated earnings and assets, like here,[18] will lead to a consistently rising securities price. This brings all kinds of benefits to management, including profits on stock holdings and options, public financings, and increased salaries and bonuses.

Petitioners contend that "options traders contribute nothing to the corporation" and thus should have no standing to seek damages against that corporation, notwithstanding the damage caused by it in the marketplace. This contention must be extended to its logical conclusion. If such a contribution is a requirement of a Section 10(b) action, then all purchasers of Beneficial common stock on the open market, who also contribute nothing to the corporation, must also be denied standing. Only purchasers of common stock in connection with a public offering contribute any capital to the corporation. Consideration paid by purchasers of common stock in the open market does not inure to the corporate issuer of the stock. *See also* pages 9-10, *supra*.

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[18] *See* Amended Complaint ¶¶25(a)(b) and 29(a)(b)(c); Resp. App. 12-17. *See also* note 8, *supra*.

In addition, listed options improve the liquidity of the stock market;[19] increase the trading volume of the underlying shares;[20] and by expanding the range of investment opportunities in the securities markets, encourage more individuals to invest and thus actually foster capital formation.[21]

Petitioners' argument that the result of the Third Circuit gives "a kind of blank check to the creators of securities, with the corporation ultimately acting as the banker" (Petition at 25) is equally faulty. As this Court has made clear, "[o]bviously neither the fact that issuers or other potential defendants under Rule 10b-5 reach a large number of potential investors . . . should in any way absolve them from liability for misconduct which is proscribed by Rule 10b-5." *Blue Chip Stamps*, 421 U.S. at 745. The Third Circuit's decision does not make the corporations "fair game," in the words of Petitioners. (Petition at 27). To the contrary, the decision is consistent with the intended deterrent effect of the federal securities laws. *See e.g., J.I. Case Co. v. Borak*, 377 U.S. 426, 432-33 (1964); *Fridrich v. Bradford*, 542 F.2d 307, 324-25 n. 6 (1976) (Celebrezze, J., concurring), *cert. denied*, 429 U.S. 1053 (1977).[22]

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[19] *See* Johnson, *Is it Better to Go Naked on the Street? A Primer on the Options Market*, *supra* at 24-26; Rubinstein, *An Economic Evaluation of Organized Options Markets*, *supra* at 55; Hayes and Tennenbaum, *The Impact of Listed Options on the Underlying Shares*, Financial Management (Winter 1979).

[20] *See* Hayes and Tennenbaum, *The Impact of Listed Options on the Underlying Shares*, *supra*.

[21] *See* Note, *Private Causes of Action for Option Investors Under SEC Rule 10b-5 . . .*, *supra*, at 1965; Rubinstein, *An Economic Evaluation of Organized Options Markets*, *supra*; *SEC Act Release No. 34-22026*, 33 SEC Docket No. 1, 18 at 24 (May 8, 1985).

[22] *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931) (Cardozo, C.J.), relied on by Petitioners (Petition at 26), does not support the proposition that an action for fraud is unavailable to option purchasers, who just like stock purchasers, foreseeably rely on corporate representations which similarly affect the markets for their investments. In fact, in restricting the scope of recovery for negligence, the New York Court of Appeals specifically preserved standing to seek damages for fraud to all those who justifiably rely on one's misconduct.

The analogy by Petitioners of call option contracts to other derivative securities, such as index options, in this context, is made to give a misleading impression of the scope of the Third Circuit's opinion.[23]

Nevertheless, the purported policy considerations advanced by Petitioners are not for the courts to weigh. As the Third Circuit found:

> [I]t is not our role as a court to pass judgment on the soundness of the legislative policy judgments which led to the creation of exchanges for option contracts, and their treatment as securities. Congress, the Securities and Exchange Commission, the Board of Governors of the Federal Reserve System, and the Commodities Futures Trading Commission all have had a role in the evolution of the market for these securities, and the policy judgment was their responsibility, not ours.

Deutschman v. Beneficial, 841 F.2d at 507 (App. 12a-13a). *See also Basic v. Levinson*, 108 S.Ct. at 987, n. 17 ("Perhaps more importantly, we think that creating an exception to a regulatory scheme founded on a prodisclosure legislative philosophy, because complying with the regulation might be 'bad for business', is a role for Congress, not this Court").

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[23] Petitioners fail to draw the distinction between calls and index options in stating that in 1987 more than $110 billion in options and index options based on the common stocks of major corporations were traded in the United States. (Petition at 3).

CONCLUSION

For the reasons set forth above, the Petition for Writ of Certiorari should be denied.

Dated: August 4, 1988

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APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

ROBERT M. DEUTSCHMAN,	) Civil Action No.
	) 86-595 (MMS)
Plaintiff,	)
	)
vs.	) AMENDED COMPLAINT
	)
	)
BENEFICIAL CORPORATION,	) Class Action
FINN M. W. CASPERSEN,	)
and ANDREW C. HALVORSEN,	)
	)
Defendants.	)

Plaintiff, for his Amended Complaint, which amends the Complaint filed in this action on December 22, 1986, alleges upon information and belief (based on, *inter alia*, the investigation made by and through his attorneys), except as to those allegations which pertain to the securities transactions of the plaintiff, as follows:

NATURE OF THE CASE

1. This is a securities class action on behalf of all persons, other than defendants and affiliated persons as defined in paragraph 15 below, who purchased the common stock of Beneficial Corporation ("Beneficial" or the "Company") or purchased call option contracts thereon, during the period August 21, 1986 through February 27, 1987 (the "Class Period"), seeking to pursue remedies under the federal securities laws and a pendent state law claim. In 1986, including during the Class Period, Beneficial and certain of its officers issued a series of public statements, including reports to shareholders and press releases, regarding Beneficial, its business, and its finances, including the business of and reserves for losses in its insurance division, which statements were materially false and misleading. These actions operated to artificially inflate the market price of Beneficial common stock and of call option contracts thereon during the Class Period, causing

the common stock to rise some $25 to $28 per share. When material adverse facts were revealed these revelations caused Beneficial stock to decline materially, inflicting damage on plaintiff and the class of securities purchasers on whose behalf plaintiff sues herein.

JURISDICTION AND VENUE

2. Jurisdiction and venue of this Court are founded on Section 27 of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §77aa, 28 U.S.C. §1331, and principles of pendent jurisdiction.

3. The claims herein arise under Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b), 78t(a), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission (the "SEC").

4. Beneficial's corporate headquarters are located at the Beneficial Building, 1100 Carr Road, Wilmington, Delaware. Many of the acts herein complained of, including the preparation, issuance and dissemination of false and misleading material information relating to Beneficial to the investing public, occurred in and from this District. In addition, each of the individual defendants transacts business in this judicial district.

5. In connection with the acts and conduct complained of, as alleged in this Complaint, the defendants used the means and instrumentalities of interstate commerce, including the United States mails and interstate telephone communications, and the facilities of the national securities markets.

THE PARTIES

6. Plaintiff, a resident of the State of California, purchased the following call option contracts using the facilities of a national securities exchange:

Purchase Date	Number of Contracts	Period & Option Price	Contract Price	Cost
11/25/86	40	Jan. 1987 at $70	$2.75/$3	$11,880
12/12/86	15	Jan. 1987 at $70	$1.50	2,349
				$14,229

On Tuesday, December 16, 1986, these contracts had lost some 99.8% of their value and were selling at less than $.50 per contract. On January 12th, just prior to the expiration of these options, they had lost substantially all of their value.

7. (a) Beneficial represents and holds itself out as one of the world's leading consumer financial services companies, concentrating on consumer credit, banking, and insurance. Consumer credit is represented to be the cornerstone of Beneficial's business and the basis of the Company's market franchise. Credit products are provided to consumers through 943 offices in the United States and 175 offices located in Canada, the United Kingdom and West Germany. The Beneficial Insurance Group of the Company provides consumer life, annuity, accident and health, and property and casualty insurance coverages, through Beneficial's credit and banking subsidiaries, unaffiliated financial institutions, automobile dealers, and through direct mail and telemarketing. Beneficial represents that its goal is to achieve superior profits by expanding its financial services franchise, and meeting consumers' needs with quality credit, deposit, and insurance products.

(b) Commencing in or about 1977, Beneficial had entered into the reinsurance insurance business. In reinsurance, the risk of loss insured against is broken up and spread among several carriers; reinsurers share claims in exchange for premiums on policies written by other insurance carriers. The possibility for profits were viewed as favorable because companies in the business could collect premiums and invest them at high rates

of return, without having to pay claims for years. Reinsurance policies in the industry were considered favorable because of the long period of time before claims are paid. Beneficial's reinsurance business was conducted principally through its subsidiary American Centennial Insurance Co. ("American Centennial").

(c) On March 3, 1987, Beneficial announced it was selling American Centennial and certain of its other insurance subsidiaries to members of its management for $10 million cash plus promissory notes with a face value of $98 million. Beneficial represented that it was assigning a "particularly conservative" value to these notes for accounting purposes "in light of the uncertainties inherent in the property and casualty insurance industry." The Company did not disclose what the actual value of the notes would be but the press reported that a Company spokesman described the actual value as "very nominal." Beneficial said also that repayment of the notes would be tied to performance and future value of American Centennial. The proposed sale is subject to regulatory approval and execution of a definitive agreement. When consummated, the sale is intended to remove Beneficial from the property and casualty reinsurance business.

(d) As of March 3, 1986, Beneficial had 22,235,591 shares of common stock issued and outstanding and had a substantially similar number of shares outstanding during the class period, hereinafter defined; its shares were listed for trading on the New York Stock Exchange ("NYSE") as well as other national securities exchanges.

(e) Beneficial call option contracts are traded on the Pacific Stock Exchange. Between September 1st and December 15, 1986 alone more than 55,000 option contracts traded, including some 6,800 January contracts enabling the purchaser of each call contract to purchase 100 shares of Beneficial at either $70 or $75 per share by mid-January, 1987.

8. (a) At all relevant times, defendant Finn M.W. Caspersen ("Caspersen") was and presently is Chairman of the Board of

Directors, Chief Executive Officer, Chairman of the Executive Committee of Beneficial, a member of the Company's Committee on Strategic Planning and Evaluation, and a member of the Company's Finance Committee. Caspersen was first elected a director in 1975. For calendar year 1985, Caspersen was paid by the Company cash compensation of $837,950, in addition to being the recipient and beneficiary of other compensation, fringe benefits, and emoluments in the form of pension plan, savings plan, stock purchase plan, and stock option plan benefits.

(b) As of February 1, 1986, Caspersen and members of his family were the beneficial owners of 832,369 shares of Beneficial common stock, which shares were owned by him, by his spouse or by family trusts and were continued to be owned throughout 1986. In addition, Caspersen is a principal trustee of the Hodson Trust, a charitable trust which owns approximately 1.6 million common shares of Beneficial, or 7% of its outstanding common stock. As one of the principal trustees, Caspersen shares the voting and investment power of such shares.

9. (a) At all relevant times, defendant Andrew C. Halvorsen ("Halvorsen") was and presently is a director, a member of the Office of President, a First Vice President and Chief Financial Officer, Chairman of the Finance Committee, and a member of the Company's Executive Committee and its Strategic Planning and Evaluation Committee. Halvorsen was first elected a director in 1984. For calendar year 1985, Halvorsen was paid cash compensation of $355,900 and in addition received other substantial compensation, fringe benefits and emoluments in the form of pension plan, savings plan, stock purchase plan, and stock option plan benefits. As Chief Financial Officer he shared the responsibility with defendant Caspersen for the accuracy of the financial and textual contents of the Company's financial reports and press releases, including the Company's annual and interim reports to shareholders.

(b) Defendant Halvorsen was a Second Vice Chairman of the Board of Directors of the Company in 1984 and 1985, a Senior

Vice President - Finance from 1982 through 1984, the Assistant to the Chairman of the Board of Directors during the years 1978 to 1981, and in 1981 and 1982 he was a Senior Vice President and Chief Investment Officer of the Company's insurance group of subsidiaries.

10. (a) The Company's Board Committee on Strategic Planning and Evaluation is responsible for undertaking such studies and evaluations as it shall deem necessary for the then current corporate strategy and the social, political and economic environment within which the Company exists and for recommending to the Board of Directors such changes in the function and composition of the Board, including new or additional members, as will best equip the Board to fulfill its duties. That committee met four times in 1985 and to date has met in excess of four times in 1986.

(b) The Company's Board Finance Committee, which met approximately 20 times in 1985 and has met approximately 15 times in 1986, has the responsibility, between meetings of the Board of Directors, to exercise all powers of the Board of Directors with respect to financing the operations of the Company.

(c) The Company's Executive Committee has the authority to exercise substantially all the authority of the Board of Directors (other than such powers which the Board has specifically delegated to other committees) during the intervals between the meetings of the Board of Directors. In 1985, the Executive Committee held approximately 20 meetings and has held a similar number of meetings in 1986.

11. Each of the defendants herein knew or recklessly disregarded the fact that the acts and practices, misleading statements and omissions particularized herein would adversely affect the integrity of the market for Beneficial common stock and call option contracts and artificially inflate or maintain the prices of such securities.

12. Each of the individual defendants is liable as a direct participant in, or an aider and abettor of, the commission of the

wrongs complained of herein. The individual defendants, because of their positions of control and authority as executive officers and/or directors of the Company, were able to and did control the content of the various financial reports, statements and press releases of the Company. As officers and/or directors of a publicly-held company, the individual defendants had a duty to promptly disseminate accurate and truthful information with respect to the Company's operations, financial condition, loss reserves, earnings, and future business prospects so that the market price of the Company's common stock would be based on truthful and accurate information.

13. The individual defendants, by reason of their management positions and/or their membership on Beneficial's Board of Directors, approved the Company's reports for filing with the SEC and the reports and releases for public dissemination and in several instances "signed off" on same, and were, during the time they held said positions at Beneficial, controlling persons of Beneficial within the meaning of Section 20 of the Exchange Act and had the power to control and influence, and did control and influence and cause Beneficial to engage in the practices complained of herein. In addition, each of said defendants acted as agent for one another and for Beneficial and so acted in their respective capacities as officers and/or directors of Beneficial.

14. *Aiding and Abetting.* Each of the individual defendants herein aided and abetted and rendered substantial assistance in the accomplishment of the acts complained of herein. In taking the actions, as particularized herein, to aid and abet and substantially assist the commission of these acts, each defendant acted with an awareness of the primary wrongdoing and realized that his conduct would substantially assist the accomplishment of the acts of gross recklessness and negligent misrepresentation herein complained of.

CLASS ACTION ALLEGATIONS

15. The named plaintiff brings this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3)

on behalf of a class ("the Class") consisting of all persons who purchased the common stock of Beneficial during the period August 21, 1986 through February 27, 1987, or purchased call option contracts thereon during that period, and have or will sustain losses as a result. Excluded from the Class are the defendants herein, members of the immediate family of each of the individual defendants, any entity in which any of the defendants has a controlling interest, and the legal representatives, heirs, successors or assigns of any of the defendants.

16. Because more than 36,000,000 shares were purchased during the Class Period at prices between $78-5/8 and $52-1/4 per share and more than 50,000 option contracts of Beneficial's common stock were purchased in the open market by numerous public investors geographically scattered throughout the United States during the Class Period, the members of the Class are so numerous that joinder of all members is impracticable. While the exact number of class members is unknown to the plaintiff at this time and can only be ascertained through appropriate discovery, plaintiff believes there are more than 2,000 members of the Class. Record owners and members of the Class may be identified from records maintained by Beneficial and/or its transfer agent, from the records of the National Securities Clearing Corporation, the Pacific Stock Exchange, and through broker-dealers who executed trades, and class members may be notified of the pendency of this action by mail, using the procedures and form of notice similar to that customarily used in securities class actions of this nature.

17. Plaintiff's claims are typical of the claims of the members of the Class as plaintiff and all members of the Class sustained damages arising out of defendants' wrongful conduct in violation of federal and state law complained of herein. Plaintiff's claims are typical of the claims of the members of the Class in that they and the class members each purchased shares of common stock of Beneficial during the Class Period and thereby sustained injury as a result.

18. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

19. A class action is superior to other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual class members may be relatively small, the expense and burden of individual litigation make it impossible for the class members to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

20. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) Whether the federal securities laws and state law of negligent misrepresentation were violated by defendants' acts as alleged herein;

(b) Whether documents, releases, and statements disseminated to the investing public and the shareholders during the Class Period omitted and/or misrepresented material facts about the business and finances of Beneficial;

(c) Whether the defendants acted willfully, recklessly or with gross negligence in omitting to state and/or misrepresenting material facts or in aiding and abetting the making of such misstatements;

(d) Whether the market price of Beneficial common stock and of call option contracts during the Class Period was artificially inflated due to the nondisclosures and/or misrepresentations complained of herein; and

(e) Whether the members of the Class have sustained damages and if so, what is the proper measure of damages.

SUBSTANTIVE FACTS ON WHICH THIS COMPLAINT IS BASED

The Positive Statements Made By Defendants to Portray a New Beginning for Beneficial With the Problems of Its Reinsurance Business Behind It. — "That is It. It's Done."

21. In reporting the results for 1985 in the Annual Report to Shareholders, as to the Beneficial Insurance Group, defendants represented in a letter to shareholders over the signature of defendant Caspersen:

> 1985 was a transitional year for the Beneficial Insurance Group (BIG). Under a new top-management team, supported by realigned and expanded middle-management ranks, the insurance Group made great progress toward mitigating the risk of future loss exposure resulting from our previously-written property and casualty reinsurance business. Concurrently, the BIG management team made major strides in refining and strengthening our powerful consumer credit insurance and annuity businesses. It also began development of other profitable personal line products that will enable the Beneficial Insurance Group to reestablish itself as a highly profitable consumer insurance business, offering a broad line of retail insurance products.

It was further represented at page 25 of that Annual Report:

> Beneficial Insurance Group
>
> 1985 was a year of substantial progress for the Beneficial Insurance Group (BIG). Although net earnings of the Group were only modestly improved to $5.0 million from $1.9 million in 1984, major studies were made toward solving the problems of the Group's property and casualty (P&C) reinsurance operation, which has been such a serious drag on BIG's recent results. BIG's operations were redirected and refocused

during 1985, laying the groundwork for what is anticipated to be a dramatic recovery in Insurance Group profitability over the next several years.

BIG's principal business segments – credit insurance and annuities – continue to be quite profitable. BIG's total premium revenue rose 26% to $711.3 million in 1985 from the prior year's $565.1 million, led by increases in annuity writings and credit insurance. *The reinsurance results, however, continue to offset the Group's otherwise excellent performance. The losses that emerge from reinsurance reflect the past mistakes of entering the reinsurance market at a point in its business cycle where premiums were insufficient in relation to risks insured, compounded by a business strategy focusing on the utilization of managing general agents (MGA's)* (Emphasis added.)

22. From January 1986 through August 15, 1986, the common stock of Beneficial traded between $45 and $54.50 per share. In the six weeks preceding Friday, August 22, 1986, the high, low and closing prices were as follows:

Week Ended Friday	High	Low	Close
July 18	$48.00	$45.25	$46.00
July 25	46.75	46.00	46.50
August 1	48.25	46.125	47.125
August 8	47.50	46.00	47.375
August 15	47.625	47.00	47.625
August 22	75.25	44.25	73.00

23. After August 22, 1986 and until December 12, 1986, Beneficial common stock traded between $64.625 per share and $79 per share, closing on December 12th at $65.00, having traded that day as high as $69. From December 16, 1986 to March 3, 1987, the shares traded from $52.25 to $65.25, and at a high of $62 and a low of $61.25.

24. The precipitous rise in the price in late August 1986, from its trading range immediately prior thereto — namely, an increase of some $30 per share — resulted from the Company's announcement of August 21, 1986, principally contained in a letter to shareholders over the signature of defendant Caspersen, described herein at paragraph 25.

25. (a) On August 21, 1986, the following letter was sent to the shareholders of Beneficial over the signature of defendant Caspersen and at the same time was issued by Beneficial in the form of a press release to the national wire services:

> To Our Shareholders:
>
> Over the past several years your management has been implementing a strategic program designed to strengthen our businesses, improve profitability and minimize the values inherent in Beneficial for our stockholders.
>
> As a result of our efforts, the company's financial performance has improved markedly and we are now clearly focused on the businesses we know best — providing a wide range of financial services to consumers. Moreover, we have in place the assets, organization and, most importantly, the people that make Beneficial a leading competitor in the consumer financial services marketplace.
>
> Having achieved the initial objectives of our strategy, we began in the early part of 1986 to plan the next phase. We concluded that there are several available paths which would enable our shareholders to realize the enormous value inherent in the Company. Accordingly, in June, we began consulting with the First Boston Corporation as independent financial advisor to work with us in exploring the full range of possibilities...

Today, your Board of Directors authorized your company's management and First Boston to evaluate thoroughly the full range of tactical and strategic alternatives that would enable us to maximize value for you, our shareholders. These alternatives may include, among other things, the sale of Beneficial, merger or other business combination with another entity, the sale of certain assets, repurchase of debt and equity securities and spin-off or sale of subsidiaries. Obviously, at this point, we cannot predict the outcome of the process nor which, if any, of the alternatives will be recommended. We can, however, assure you of the most comprehensive effort to identify and pursue the most meaningful and profitable course for Beneficial and all of its shareholders. *In this connection, the Board of Directors has authorized employment contracts for certain officers of the company and a value-created incentive cash bonus plan for certain key executives who are, and will be, instrumental in successfully achieving the strategic alternatives which may be implemented by the company. The plan provides for payments equal to an aggregate of 7 percent of the increase in the price of the company's common stock above $70 per share upon the earlier of the sale or major restructuring of the Company or the end of 1987.*

* * *

In order to facilitate whichever strategic course is decided upon, we have determined to anticipate any future adverse loss development in our insurance business by recording a special reserve addition to our property and casualty reinsurance reserves.

While final actuarial, accounting, tax and legal analyses are not yet complete, it appears that a reserve addition of roughly $260 million pretax (approximately $150 million net, after tax benefits) may be booked

> *before year-end to build claim reserves for anticipated ultimate loss emergence and to cover reinsurance recoverables, both related to the run-off of the Company's terminated book of property and casualty reinsurance.* This reserve addition is clearly the proper course of action to deal aggressively and forthrightly with this situation and clear the way for the realization of shareholder value. *In order to be particularly conservative, the reserve addition would include provisions sufficient to bring reserves of our major property and casualty subsidiary to "high prudent" – the upper end of the range of estimates provided by our outside actuaries* (Tillinghast, a division of Towers, Perrin, Forster and Crosby). (Emphasis added.)

(b) The foregoing was reiterated in a Report on Form 8-K filed by Beneficial with the SEC on August 28, 1986, by the inclusion of that letter verbatim, wherein the company reported, *inter alia*:

> The Company has begun to evaluate thoroughly the full range of tactical and strategic alternatives that would maximize shareholder value. These alternatives may include, among other things, the sale of Beneficial, merger or other business combination with another entity, the sale of certain assets, repurchase of debt and equity securities and spin-off or sale of subsidiaries.

The representation was further reiterated at page 7 of the Company's Report on Form 10-Q dated November 12, 1986, for the quarter ended September 30th.

26. The 66% increase in the market price of Beneficial stock resulted from the foregoing August 21st announcement. Value Line's Investment Survey dated September 19, 1986 at page 2058 reported the following with respect to that August 21st announcement:

Wall Street's reaction was enthusiastic. Beneficial shares skyrocketed 66% to $73 on the day after the disclosure. One needn't look hard for the reason: The company is among the leading credit card issuers in the United States, with over $1 billion in receivables, its second-mortgage portfolio ($3.1 billion) is the largest in the nation, and its credit insurance and annuity businesses are very profitable. Moreover, Beneficial's reserve for credit losses is so high that it could safely be reduced to provide funding for greater receivable growth.

A $2.25-a-share writeoff in the September quarter for anticipated future losses is positive. Over the past 18 months, Beneficial's earnings have been plagued by losses from its property/casualty reinsurance business, which was discontinued in 1984. This scuttled segment produced aftertax losses of $58 million prior to this year and $17 million in the first half of 1986. An actuarial reassessment indicated there was potential for more red ink. The charge will result in a huge operating loss for 1986, but it will substantially strengthen the balance sheet.

Value Line concluded that "the earning power of Beneficial's core financial services business can command a share price in the $90-$100 range."

27. Thus, the investment community believed that the August 21st statement clearly was reliable and that management had established a reasonably based and conservatively prudent reserve at the upper end of the range of estimates for losses from its discontinued reinsurance business.

28. (a) A *Wall Street Journal* article of September 2nd, by Laurie Hays, a staff reporter, entitled "Reinsurance Woes Threaten Beneficial" reported:

> Late last month, the financial-services concern announced it will put another $260 million into its reserves for current and future losses. The company expects to post a $50 million loss for the year.

(b) Defendant Caspersen was quoted in this *Wall Street Journal* article, as follows:

> "We got taken to the cleaners . . . . But it's our view that we've put the problem behind us. This is it. It's done."

The representation that the problem was behind the Company — "This is it. It's done" — was materially false and misleading, as hereinafter more particularly alleged at paragraph 48, *infra*.

(c) On September 2, 1986, the closing price of Beneficial common stock was $73. Following Caspersen's statement described herein, the price increased to $74-7/8 on September 3rd, and $75 on September 4th.

29. (a) On October 31, 1986, Beneficial reported its third quarter results for the three months ended September 30, 1986. Beneficial reported a net loss of $126 million or ($5.80) per share compared to reported earnings of $26 million and $.99 per share the prior comparable period ended September 30, 1985. For its Beneficial Insurance Group, Beneficial reported a $160.4 million net loss for the quarter, which reflected a $260 million pretax addition to reinsurance reserves.

(b) The common stock of Beneficial closed at $74.25 per share on October 31, 1986. The $260 million loss reserve as announced had been expected and was consistent with the representations made in the August 21st announcement of Beneficial and the September 2nd representation of Caspersen as contained in the *Wall Street Journal*, that the Company's reinsurance problems were behind it. Accordingly, the market price of Beneficial securities was not impacted adversely.

(c) The foregoing was reiterated in the Report on Form 10-Q filed by Beneficial for the quarter ended September 30, 1986 signed by defendant Halvorsen. Specifically, it was reported in that 10-Q, at page 6:

> Insurance policy and claim reserves increased $620 [million] or 34% during the nine months of 1986 due to additional annuity writings and the recording of additional insurance reserves of $260 [million]. This reserve strengthening was based upon recently completed actuarial studies and is intended to cover anticipated loss emergence and reinsurer insolvencies, both related to the runoff of the Company's terminated book of property and casualty reinsurance.
>
> * * *
>
> . . . The additional reinsurance reserve of $260 recorded during the third quarter of 1986 resulted from intensive internal and external actuarial studies to assess the effect of loss emergence and reinsurance insolvencies in the runoff of the Company's terminated book of property and casualty reinsurance business.

and at page 8 thereof in the notes to the financial statements, the following was reported:

> 3. During the third quarter of 1986, actuarial studies were completed and a $260 special addition to insurance reserves (approximately $150 after-tax) was recorded. This reserve addition was recorded to provide for loss emergence and reinsurer insolvency in the company's terminated property and casualty reinsurance business.

(d) Further, the letter to shareholders over the signature of Caspersen dated November 12, 1986, contained in the interim

report to shareholders for the third quarter 1986, emphasizes the alleged thoroughness used in computing the $260 million increase in insurance reserves, as follows:

> The Beneficial Insurance Group (BIG) reported a $160.4 million loss for the 1986 third quarter compared to prior year earnings of $1.6 million. For the nine months, the Group had a net loss of $152.9 million compared to profits in 1985 of $2.0 million. In September, BIG recorded a $260 million increase in reserves for the property and casualty reinsurance business. This reserve strengthening was a result of in-depth internal and external actuarial reviews which utilized the more complete information now available from the successful migration of BIG's managing general agent records to an in-house system. In addition, the acturial projection takes into consideration the adverse loss development that was experienced since the third quarter of 1985. Additional reinsurance losses of $20 million pretax were recorded to strengthen insolvency reserves relating to insolvency occurrences in 1985 and prior years, that were not covered by the previously executed aggregate excess contract, reflecting the higher reserve levels of the overall reinsurance book of business. As expected, new exposure reinsurance premium writings continue to decline quarterly.

Beneficial as a whole reported losses of $126 million and $68.7 million for the three and nine months ended September 30, 1986, respectively.

30. Analysts perceived, consistent with Caspersen's reported statement in the September 2nd *Wall Street Journal* article, that

Beneficial's problems with its reinsurance business were behind it. As reported in *Value Line* on page 2056 of its Investment Survey dated December 19, 1986:

> *We think Beneficial has put a long-standing problem behind it, for a price.* Even after the company withdrew from the troubled property/casualty (P/C) reinsurance business in 1984, claims arising from when its policies were in force necessitated sizable loss reserve problems. A recent actuarial reassessment indicated that more of the same was in prospect so Beneficial moved quickly to plug the dam. The company wrote off $260 million (about $150 million after-tax) as a special addition to insurance reserves. To be sure, this will produce a huge operating loss for 1986, but we think management is making the right move. This charge is more than three times greater than the cumulative P/C losses Beneficial has experienced to date, *and almost certainly eliminates the need for further P/C reserve strengthening for several years. Consequently, this scuttled line, in our view, will no longer burden Beneficial's earnings.* [Emphasis added.]

31. At no time, commencing with the August 21st press release, was there any disclosure of the Company's intentions to take a write down resulting from the discontinuance of its property and casualty reinsurance business or a write down as a result of a sale thereof or of the need to restate previously reported financial statements to reflect such a write down. To the contrary, the problem had been represented as having been behind the Company.

The February and March 1987 Disclosures

32. In an article appearing in the February 26, 1987 issue of the *Wall Street Journal*, of Laurie Hays entitled "Beneficial

is Expected to Post 1986 Loss Far Wider Than $50 Million Forecast," it was reported that Beneficial's losses for 1986 would "far exceed [ ] the $50 million loss company officials previously anticipated" as reported in the *Wall Street Journal* of September 2, 1986, and attributed to Caspersen in the *Wall Street Journal* of December 16, 1986. The article reported that analysts estimated the Company would post a loss between $80 million and $112 million.

33. On February 26, 1987 Beneficial announced in a press release:

> "Beneficial Corporation today reported a net loss of $171.6 million for 1986 compared to net income of $101.2 million in 1985.
>
> While 1986 income from continuing operations increased 20 percent to $88.1 million from $73.3 million in 1985, a $279.1 million net loss from discontinued operations was incurred relating to the company's previously announced restructuring plan. The restructuring involves the sale of the company's bank credit bank subsidiary, most of the companies making up the Beneficial Insurance Group. . . .
>
> The $279.1 million net loss from discontinued operations is comprised of $147.3 million in net losses from operations discontinued in 1986, which reflects the massive losses of Beneficial's discontinued property and casualty insurance subsidiaries, and a $131.8 million estimated loss on disposal of discontinued business."

34. (a) On or about February 27, 1987, the *Wall Street Journal*, in an article entitled "Beneficial Posts Loss for 1986 of

$171.6 Million," stated that Beneficial reported a 1986 loss of $171.6 million, primarily due to heavy reinsurance losses and a write down for the sale of the insurance unit, that this loss included a loss from discontinued operations of $279.1 million, and that Beneficial's reinsurance operation contributed significantly to the loss. The previous three quarters of fiscal 1986 were reportedly restated to reflect the discontinued operations.

(b) The February 27th *Wall Street Journal* article further reported with respect to statements of defendant Halvorsen:

> Andrew C. Halvorsen, chief financial officer, said Beneficial's ailing reinsurance unit, American Centennial Insurance Co., contributed "significantly" to the loss. *Beneficial in the fourth quarter pumped additional funds into reserves for the unit, beyond the $260 million added to reserves in the third quarter, Mr. Halvorsen said.*
>
> He declined to specify the amount of the additional reserves, but said they are included in the $279.1 million loss from discontinued operations. Beneficial took a charge of $150 million for the third-quarter addition to reserves.
>
> "There's no need to disclose the breakdown of the provision," Mr. Halvorsen said. He said the reserves were added to prepare the unit for a sale currently under negotiation. He declined to say who the buyer was or whether the state of Delaware's Department of Insurance had approved such a sale. [Emphasis added.]

This belated admission by defendant Halvorsen confirms the accuracy of the assertions in the *Wall Street Journal* article of December 16, 1986, that further reserve additions in excess of the $260 million provided in the third quarter would be required.

(c) Despite denials from Beneficial's management in mid-December 1986, hereinafter alleged and as reported in the *Newark Star Ledger* of December 17th, that further additions to the insurance reserves would be needed, such additions were in fact made in the fourth quarter, and acknowledged by Halvorsen in the *Wall Street Journal* article of February 27th.

The Attempts to Sell Beneficial and the Cover-up of Continuing Problems in Beneficial's Insurance Division After September 2nd.

35. Prior to August 21st, Beneficial's investment banker, First Boston Corp., is reported to have advised the Board of Directors of Beneficial that it could add value to the stock price by selling Beneficial by the end of 1986.

36. As an incentive to the individual defendants and particularly Caspersen, a bonus for increasing the price of the Company's common stock above $70.00 per share was promised. Thus, in addition to the substantial personal gain to be realized from a sale of his and his family's approximately 830,000 shares and the gain to the Hodson Trust from a sale of its 7% interest, Caspersen had an incentive to maximize the market price of the Company's publicly traded securities, while at the same time minimizing the magnitude of the reinsurance business losses being sustained by Beneficial.

37. In September, 1986, it was announced that management of Beneficial was asking $100 per share for the Company.

38. On November 20, 1986 the Company announced:

> It has called a special meeting of shareholders for December 23 to consider a plan of liquidation.

> The Company said it wants to take advantage of benefits available under the tax reform act's transition rules that permit the company to complete such a liquidation in 1987.
>
> Beneficial said it will provide "Maximum flexibility as it reviews and pursues restructuring alternatives."

The Company at the same time declined to disclose whether a buyer had been found for the Company.

39. On Friday, December 12th after 4:00 p.m., the Company announced it had

> canceled the special shareholders meeting that had been scheduled for Dec. 23 to consider a proposed liquidation of the company.
>
> Instead, the company's board will meet Dec. 18 to review what the company called "A variety of strategic alternatives."
>
> The company said the decision to cancel the meeting "doesn't mean that Beneficial is no longer for sale."
>
> It said the meeting was canceled because liquidation is no longer being considered an option by management, but it said liquidation may be reconsidered next year.
>
> Beneficial said the board expects to announce its "conclusions" about the restructuring at its December 18 meeting.
>
> The company said the restructuring alternatives include sale of the company. A merger with another entity, sale of certain assets, repurchase of securities and the spin off or sale of subsidiaries.

40. (a) In a December 16th *Wall Street Journal* article by Laurie Hays, entitled "Beneficial Corp. is Expected to Bolster its $260 Million Reinsurance Reserve," it was reported that the Company is "expected to have to bolster the $260 million reserve set aside in the third quarter for its troubled reinsurance business . . . needed to cover claims that were overlooked in an earlier audit. . . ."

(b) The article further reported the following with respect to statements of defendant Caspersen:

> *"This is it*
>
> We've put the problem behind us," Finn M.W. Caspersen, Beneficial's chairman, said at the time of the change. *"This is it. It's done."*
>
> * * *
>
> As previously reported, Beneficial put itself up for sale in late August when Mr. Caspersen announced the significant and unexpected losses in the company's reinsurance business. At the time, Mr. Caspersen said some of the losses were the result of fraud. *He said also the $150 million charge was expected to result in an earnings loss of $50 million for the year.* [Emphasis added.]

(c) Ann Stephenson, Beneficial's Vice President - Public Affairs, was quoted as follows in the article:

> Beneficial declined to discuss whether the company would take further reserves. "We have and we are taking all action as we deem appropriate with respect to reinsurance," said a spokeswoman.
>
> She said the company is "always reviewing" all accounting relating to the reinsurance reserves.

41. As a result of the disclosure of the foregoing in the *Wall Street Journal* of December 16th, the market price of Beneficial common stock dropped some 20%. On December 16, 1986, the common stock closed at $57-1/8 after trading as low as $54-3/4, having precipitously declined some 20% from its December 12, 1986 closing price of $65.

42. (a) Beneficial responded to the December 16, 1986 *Wall Street Journal* article by falsely or recklessly asserting, through Ann Stephenson, that Beneficial had "no intention to increase our reserves above what was set aside in the third quarter. Outside actuaries have told us that our reserves are currently at the upper end of the range required. We are not conducting any further audits and we don't believe that any are necessary." These remarks were quoted in the *Newark Star Ledger* on December 17, 1986.

(b) On December 16, 1986, the Insurance Commissioner of Delaware was caused to issue a press release claiming that his remarks had been taken "out of context" by the *Wall Street Journal* and that Beneficial "is a respected corporate citizen of the State of Delaware." These comments were also disseminated in the press as a result of a press release, dated December 16, 1986, issued by the State of Delaware Insurance Department.

(c) In substance, Beneficial and the individual defendants had caused a denial of the need for any additional reserves and a denial of any additional financial problems relating to its reinsurance business, which denials were not reasonably based and had to have been known to them to be false.

43. The market price of Beneficial common stock has continued to fall in December, opening on December 19, 1986 at $56, $3 below the close on December 18, 1986, and trading as low as $54.75. Notably, the market price of Beneficial common stock would have plunged even further if defendants had not sought to cover up the difficulties suffered in the Company's reinsurance business.

44. On December 19, 1986, Beneficial announced that the Company's Board of Directors had approved a restructuring plan. The Company's press release as carried over the Dow Jones News Service, stated in pertinent part:

> Beneficial Corp. said its board approved a restructuring plan involving the sale of "significant segments" of certain businesses, in an effort to streamline the company and return it to its basic operation.
>
> The company said proceeds from the sale of the units, which include some insurance business, could exceed $1.4 billion after tax, but before repayment of certain inter-corporate advances. Beneficial said after the repayment the proceeds would be about $750 million.
>
> The company does not have buyers for these businesses and said it will "aggressively pursue" a restructuring involving the sale of the businesses. The businesses to be sold include, Beneficial credit card subsidiary, Western National Life Insurance Co., Beneficial's annuity insurance subsidiary and other companies making up the Beneficial Insurance Group, including the domestic and international property and casualty subsidiaries.
>
> Beneficial said it also would pursue the sale or joint venturing of its investment real estate properties.
>
> Beneficial said selected additional segments of its businesses not related to the core consumer lending operations, also will be under review for possible sale.
>
> The proceeds will be used to reduce short- and long-term debt and to fund growth in the consumer finance

business, the company said. In addition, a portion of the proceeds is planned to be used for a repurchase of an as yet undetermined amount of Beneficial common stock, in an effort to maintain or improve credit ratings.

As previously reported, Moody's Investors Service Inc. lowered its ratings on all of Beneficial's $4.4 billion of debt in October. The rating concern cited Beneficial's increased loss provisions for property and casualty insurance.

45. Also on December 19, 1986, Beneficial announced that its Board had rejected an offer from a "major U.S. corporation" to acquire all of Beneficial's operations except the Company's reinsurance business. The Company's press release, as carried over the Dow Jones News Service, stated in pertinent part:

Beneficial Corp. said it decided on the restructuring of its operations despite an offer from a "major U.S. corporation" to acquire all of Beneficial's operations, except those associated with its property and casualty insurance business.

Beneficial said the proposal from the unidentified corporation was for $1.92 billion, or $83 a share in cash, but was subject to "significant conditions" and retention by Beneficial of certain liabilities, in addition to those associated with the insurance business. Beneficial said it learned one day before its directors met that the board of the proposed acquiror hadn't approved the transaction. Beneficial said it then received a new proposal from the same company but the price was reduced to $1.74 billion, or $75 a share.

The new proposal also was subject to the earlier conditions. Beneficial said the board rejected the proposal because the price was "inadequate" and the conditions "unacceptable."

COUNT I

AGAINST ALL DEFENDANTS FOR VIOLATION OF SECTIONS 10(b) AND 20(a), AND RULE 10b-5 OF THE EXCHANGE ACT

46. Plaintiff incorporates paragraphs 1 through 45 as though set forth fully herein.

47. Throughout the Class Period. defendants, singularly and in concert, pursuant to a common course of conduct and using the means and instrumentalities of interstate commerce (including the United States mails), knowingly and/or recklessly (a) employed devices, schemes and artifices to defraud; (b) omitted to state material facts necessary in order to make the statements made in light of the circumstances under which they were made not misleading; and (c) engaged in acts, practices and a common course of business which operated as a fraud or deceit upon plaintiff and the Class as herein alleged and acted as a market manipulation of Beneficial securities. The purpose and effect of said scheme was to (i) conceal all the adverse facts concerning its business and particularly the reinsurance loss reserve; and (ii) to maintain an artificially high market price for the common stock of Beneficial in order to insure a sale of the Company, if it were to be sold, at greater than $70 per share. Particularly, Beneficial aided and abetted by the individual defendants recklessly or deliberately engaged in a "cover-up" of material information relating to its property and casualty reinsurance business.

48. On August 21, 1987, the Company announced the increased reserve for reinsurance losses, and on September 2nd, the *Wall Street Journal* quoted defendant Caspersen as saying, with respect to the losses associated with reinsurance business, "This is it. It's done," and again on December 16th when the *Wall Street Journal* repeated the same quotation of defendant Caspersen, plaintiff and the class reasonably could believe that

whatever problems the Company had had with its reinsurance business, were recognized and evaluated, with an appropriate and sufficient reserve, and the problem put behind it, and that Beneficial was poised for growth and profitability, either through operations or through a sale or restructuring of its business.

49. At no time after December 16, 1986, or following September 2, 1986 did defendants attempt to correct this untrue statement of Caspersen that the problems with the reinsurance business were behind it, nor the misleading impression created by it. Defendants made no effort to disclose on or about December 16th, when the news of a further audit was disclosed, that it would be necessary to or possible that it would have to increase its reserves, and that a materially greater loss than the $50 million expected, as reported by the *Wall Street Journal* on September 2nd and December 16th, would foreseeably result. To the contrary, the defendants made an affirmative effort to dispel the truthfulness of the disclosures in the *Wall Street Journal* article of December 16th that the Company's problems with its reinsurance unit were not behind it and that additional audit work was being undertaken. Moreover, defendants did not correct the misleading impression created by its statements in the fall of 1986 that the audit work associated with the establishment of the $260 million reserve was thorough.

50. The defendants knew, or were reckless in not knowing, that the reserve projections first announced on August 21st and reiterated in September and October were materially understated and such understatement, as well as the disclosure of realistic reserves, would adversely impact a sale of the Company.

51. The August 21st announcement had a further manipulative effect on the market price for Beneficial common stock by creating an artificial floor on the stock's market price by suggesting, without reasonable basis in fact, that $70 was the minimum fair value for the Company's shares.

52. As a result of the material misrepresentations and material omissions and other conduct complained of, which continued throughout the Class Period, securities of the Company were purchased by the plaintiff and other members of the class at artificially inflated prices and in a false market climate crea' 'd by defendants.

53. As a result of the defendants' misrepresentations and material omissions complained of, plaintiff and the other members of the class suffered substantial losses on their securities purchased in the Class Period and were damaged thereby.

COUNT II

AGAINST ALL DEFENDANTS UNDER THE COMMON LAW OF NEGLIGENT MISREPRESENTATION

54. Plaintiff incorporates paragraphs 1 through 53 as though fully set forth herein.

55. Among the direct and proximate causes of the misrepresentations and omissions to state material facts set forth above was the negligence and carelessness of the defendants.

56. At the time of said misrepresentations and omissions, plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. In reliance on said misrepresentations and in reliance upon the superior knowledge and expertise of defendants, and in ignorance of the true facts, plaintiff and other members of the class were induced to and did purchase Beneficial securities. Had plaintiff and other members of the Class known the true facts, they would not have taken such action. By reason thereof, they have been damaged. Said reliance by and damage to the Class was foreseeable to each defendant.

WHEREFORE, plaintiff demands judgment, as follows:

1. Determining this action is a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure;

2. Awarding to plaintiff and the other members of the Class damages from Beneficial and the individual defendants, jointly and severally, together with appropriate interest;

3. Awarding to plaintiff and the other members of the Class relief as may be just and proper under the circumstances; and

4. Awarding to plaintiff and other members of the Class the costs and disbursements of this action, including reasonable fees to plaintiff's attorneys, accountants and experts.

Dated: March 5, 1987

BIGGS & BATTAGLIA

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